# LIABILITY OF BANKS RECEIVING CHECKS TO A TRUSTEE'S ORDER FOR DEPOSIT IN HIS INDIVIDUAL ACCOUNT.

Until a very recent period, and probably up to the present time, the banks and trust companies of New York City have been engaging, in good faith, in a transaction which recent developments in the law of this State have shown to be extremely hazardous. It has been usual, at least, if not a general custom for them to permit a trustee, guardian, executor or other person occupying a fiduciary position to deposit in his individual personal account, after regular indorsement, checks which have been drawn to his order as such trustee, guardian or executor. The question now presented for consideration is whether the bank or trust company is liable for allowing such a deposit in the individual account, where it subsequently develops that he has drawn checks against his individual account and has thus misappropriated the moneys of his trust. We will assume that the trustee has both a representative and an individual account in the same bank.

At first sight, it would seem that the company would be free from liability. The checks, in the transaction supposed, are properly indorsed by the person having authority to indorse them and they could therefore be presented by the payee and their cash proceeds could be obtained by him. Such a proceeding, of course, under ordinary circumstances could not render the bank liable.[1] The trustee could then leave the bank and at some later period return with the cash and deposit it in his individual account. Without question no liability would arise from such a transaction. There is a distinction, however, between such a receipt of cash and the case under consideration, for in the latter case the bank is charged with knowledge that the fiduciary moneys have gone into a personal account.

Some time about the year 1905, certain financial institutions, which had frequently permitted such deposits, began to grow somewhat uneasy upon consideration of the possible danger to themselves. Naturally, unless the danger was really serious, they did not desire to disturb their business methods. Furthermore, it would have been a rather delicate matter, in many instances, for them to suggest to their depositors the discontinuance of such deposits. The suggestion might imply a suspicion as to the hon-

[1]Peerrot *v.* Mt. Morris Bank (N. Y. 1907) 120 App. Div. 247.

esty of the trustee's dealings and thus cause a loss of both the representative and the individual accounts.

Under such circumstances the companies naturally turned to their counsel for advice as to whether the danger which lay for them in these transactions was sufficient to counterbalance the disadvantages which would result from a change in their practice. The question was considered with care by several eminent attorneys who represented banking institutions in the city. Upon a thorough investigation, this condition in the law was found to exist. In New York State the question was unsettled. Outside of New York State the weight of authority indicated that the banks would not be liable under the circumstances supposed and without further notice of intended misappropriation. On the other hand, however, the courts of some States indicated that the banks permitting such deposits, if not liable, were at least upon dangerous ground.

In New York State the question of liability was extremely unsettled. The line of settled authorities nearest in point were those which held that a person who takes money or property as a trustee has no apparent authority to dispose of it in payment of his own debt. Thus in *Gerard* v. *McCormick*,[2] which seems to have been the leading case upon this question, the facts were as follows:

B., as the agent of the plaintiffs, had charge of certain premises known as the "Glass Buildings." He deposited the rents collected to the credit of a bank account kept in his name as "Agent, Glass Buildings." In payment of a debt which B. owed defendant, as collateral for which the latter held certain securities, the defendant received a check on the bank signed by B. with the words "Agt., Glass Buildings" following his signature, and on such receipt surrendered the securities. The check was paid by the bank and charged to said account. B. had no authority to so use the funds. In an action to recover the amount, there was no evidence tending to raise any question as to the defendant's good faith, except his receipt of the check.

In holding that the form of the check was sufficient to indicate to defendant the existence of an agency and to put him on inquiry as to the agent's authority to so use the money, the court expressed itself thus:[3]

[2](1891) 130 N. Y. 261.

[3]*Supra*, 267, 268.

"It is a legal though a rebuttable presumption, that one who holds money or property as agent, trustee, executor, administrator, guardian or partner, has no authority to dispose of it in payment of his own debt.

"This brings us to the question whether the form of the check was sufficient to put the defendant upon inquiry as to the authority of Boswell to use the money in payment of his debt.

"* * * The check gave the defendant notice that William Boswell did not assume to be the beneficial owner of the account against which he drew, but that he held it as agent, and also as agent for the Glass Buildings. Had he signed as agent for Sarah M. Gerard and others, owners of 'Glass Buildings,' the efficiency of the notice that the drawer of the check was not the owner of the fund against which it was drawn, could not be questioned under any well-considered authority. We think that the form of the signature to the check was sufficient to put the payee on inquiry as to the right of the agent to pay his personal debt out of the fund."

The *Gerard* case has been consistently followed. In *Rochester & C. T. R. Co.* v. *Paviour,*[4] the payee of corporate checks received them from the treasurer of the corporation in payment of a debt not owed by the corporation but in payment of one which he had treated as the treasurer's individual debt. The latter had no actual or apparent authority to issue such checks in payment of his own debt.

The court held that the payee was chargeable with notice of the treasurer's incapacity thus to issue the checks, saying:[5]

"The checks themselves gave notice of a suspicious fact and invited inquiry in relation thereto. *They showed upon their face that Briggs was apparently using the money of the plaintiff for his own purposes,* since they were not his checks but the checks of a corporation issued by him as its treasurer. In the absence of express authority, or of that which may be implied from past conduct known to the corporation, he could not lawfully use the checks, which stood as its money, for such a purpose, as the defendant is presumed to have known. There was no express authority and nothing to indicate that Briggs was impliedly authorized to thus use the money of the plaintiff and the presumption was the other way."

While these cases decided that notice to the bank was given by an attempt to use representative funds for a debt *known* to be personal or apparently personal, they did not decide whether notice sufficient to charge the bank would be constituted merely by the

[4](1900) 164 N. Y. 281.

[5]*Supra,* 284.

deposit of a representative check in the individual account. In the case of a deposit in the personal account the bank would not know, under ordinary circumstances, of any *actual* application of the trust moneys to personal obligations—which might distinguish the *Gerard* case from that under consideration. It was still doubtful whether the courts would go so far as to hold that by allowing the trustee to place the funds in his individual account, whence there might be a *possible* application to personal uses, such notice would be made out as to charge the bank with the duty to make inquiry concerning the trustee's authority thus to handle the trust moneys. It is true that in *Spaulding* v. *Kelly,*[6] the court came very close to deciding this question. The action was brought by the plaintiff as assignee for creditors of private bankers carrying on business under the name of Witmer Brothers against the survivor of the firm of Ways & Kelly, to recover the amounts due on two promissory notes made by Ways, one of the members of the firm, in the firm name to his own order. The plaintiff's assignors discounted these notes for Ways and credited the proceeds to his individual account which account was subject to and was thereafter depleted by the personal check of Ways.

After referring to *Union Natl. Bank* v. *Underhill,*[7] in which case partnership paper was used to pay an individual debt, the court used this significant language:[8]

"With a slight change in the language of the Court of Appeals in applying the above principle to the case before it, we may apply the same principle to the case before us and say that *Witmer Brothers were bound to know that Ways had no right to use the partnership to create or increase his individual credit or account at the bank without the consent of his partner,* and they were chargeable with notice that the notes were wrongfully made and issued."

The *Spaulding* case was decided by the Fifth Department in 1887. For some reason it has been lost sight of since that time. While it has not been distinguished or overruled, apparently it has not been cited or referred to. Its authority, therefore, might be said to be somewhat doubtful—particularly as the courts in the First Department, which comprises the greatest banking centre, might not have been willing to follow the Fifth Department.

The law of New York State stood thus until after February,

[6](N. Y. 1887) 43 Hun 301.
[7](1886) 102 N. Y. 336.
[8]*Supra,* 306.

1909, by which time the Court of Appeals had rendered its decision of *Ward* v. *City Trust Co.*[9] and *Squire* v. *Ordemann,*[10] which held no more than what the *Gerard* and the *Paviour* cases had decided.

Outside of the State of New York, however, the weight of authority was to the effect that a bank would not be liable under the circumstances supposed.

In *Gray* v. *Johnston,*[11] the House of Lords had decided that an executrix, having a credit with bankers in her estate account, might check against this account to the order of a firm in which she was a member, deposit such check in the firm's account and subsequently use the money to pay the firm's debts without thus giving to the bankers such notice as to place upon them the duty of inquiry. So, too, in *Coleman* v. *Bucks & Oxon Union Bank,*[12] the trustee forwarded to the bank certain moneys to be placed to the credit of the trust. At the time, however, he had no trust account with the bank and the moneys were credited to his personal account. The trustee continued to draw on the account, and it subsequently proved that he had misapplied the trust funds. Recovery was refused upon the ground, in part, that if there had been a trust account, the trustee, without rendering the bank responsible, could have "drawn a check for the amount and paid it into his private account."

In *Shields* v. *Bank of Ireland,*[13] one of two executors forwarded estate moneys to the Bank of Ireland to be credited to his individual account. The bank knew that the moneys were a part of the estate but nevertheless was absolved from liability. The court, in rendering its decision, took occasion to comment upon the business difficulties which would be necessitated by imposing upon the bank a duty to make inquiry as to whether the trust funds were being properly applied:

"In the present case, the bank had notice that the two sums in question had come to the hands of their customers, James and Michael Shields, and that they were the executors of Patrick O'Neill. What were they to do when the money was brought to be lodged to the credit of Patrick and Michael Shields' account? Were they to say, show us how you as executors are entitled to

[9](1908) 192 N. Y. 61.
[10](1909) 194 N. Y. 394.
[11](1868) L. R. 3 H. L. 1.
[12][1897] 2 Ch. 243.
[13][1901] 1 Ir. R. 222, 237.

lodge this to the account of one of yourselves. Fancy such a question being put across the counter by a bank clerk! And if the money was once received and dealt with in that way, what was to be done? The bank had no power of themselves to set up a new account, 'trust account, &c.' The whole thing was completed once the credit was given to the account of P. & M. Shields. Yet for all the bank knew, the fund might have belonged to Michael Shields beneficially."

In this country, also, the tendency of the courts was to refuse recovery against the bank.

In *Batchelder* v. *Central National Bank of Boston*,[14] a check drawn to the order of the trustee was indorsed by him and deposited in his individual account. Thereafter the moneys were misapplied. The court dismissed the bill against the bank, saying:

"Under those circumstances it cannot be ruled as a matter of law that for him to deposit to his personal account funds which he took as trustee was a dishonest act on his part, or that the circumstance that the check so deposited was one payable to his order as trustee gave the bank reason to believe that the depositor was acting dishonestly."

So, too, in the case of *Safe Deposit & Trust Co.* v. *Diamond National Bank*,[15] an administrator, who had no estate account, indorsed checks drawn to his order as administrator and deposited them in his individual account whence they were checked out and misappropriated. The court, in applying the analogy of a cash transaction, thus expressed itself:

"Upon the checks which were received by the administrator, he had the undoubted right to draw the money; and if he chose, thereupon, to deposit the money thus received to the credit of his own account, he had a perfect right to do so. What he did do was nothing more than equivalent of such action on his part."[16]

It is true that in the *Batchelder* and the *Safe Deposit Company* cases the trustee did not have any trust account in the bank, which fact may perhaps render these cases different from the present one. Where there is a trust account in the bank, clearly such account should receive the deposit of trust funds. If, however, there is only an individual account there is less apparent impropriety in allowing such account to receive the deposit. The same principle, however, would probably control both cases, for if there

[14](1905) 188 Mass. 25.

[15](1900) 194 Pa. St. 334.

[16]See also Rhinehart *v.* New Madrid Banking Co. (1903) 99 Mo. App. 381; Martin *v.* Kansas Nat. Bank (1903) 66 Kan. 655.

is a fault upon the part of the bank in allowing trust moneys, with its knowledge, to percolate into the individual account, the obvious preventative of liability would be to require the trustee to open a trust account for trust funds.[17] At any rate, no distinction has as yet been made between the two classes of cases.

Depositaries, moreover, had been held faultless even where a trustee had a trust account, as well as an individual account. In *Goodwin* v. *American National Bank*,[18] an executor had both an estate and an individual account in the same bank. The bank discounted for him an estate note, receiving as security certain property of the estate. The proceeds of the discount were credited to the executor's individual account and he subsequently misapplied them to his own uses. The court decided in favor of the defendant, basing its opinion upon this reasoning:

"And a check drawn either individually or officially, payable to order or bearer, is so nearly the equal of currency in case of transfer, and performs so many offices of payment between individuals and executors, between the latter and trustees, and between these again and individuals, without giving any evidence when presented either of the number or character of the transactions of which it has been made a part or of the payments which it has effected, that *the law will not charge the officers of a bank with knowledge that a depositor has committed a fraud, nor impose upon them the duty of inquiry, because he has drawn upon a treasurer's account checks payable to himself or to bearer, or has transferred money from it to his own and from his own to it.* They are not required to assume the hazard of correctly reading in each check the purpose of the drawer."

On the other hand, all of the courts, before whom these questions had been taken, did not concur in absolving the financial institutions. In *Farmers' Loan & Trust Co.* v. *Fidelity Trust Co.*,[19] a draft drawn by a general land agent upon his principal had been cashed for him by the plaintiff Trust Company. For the proceeds he received from it a certificate of deposit in his individual name. The money raised upon this certificate was used for individual purposes. The court said, in holding that the plaintiff could not recover from the principal the amount advanced to the agent upon the draft:

"When an agent draws a draft in the name of his principal, and receives from a bank money therefor, the presumption, in the

[17] Commercial Bank *v.* Jones (1857) 18 Tex. 811, 819.

[18] (1881) 48 Conn. 550.

[19] (1898) 86 Fed. 541.

absence of any showing to the contrary, is that he receives the money in the same capacity in which he draws the draft; that is to say, as agent. *But when the agent, for such draft, asks for and receives from the bank a certificate of deposit in his individual name, not only is such bank thereby put upon inquiry as to why, for money of the principal, the agent wants such certificate in his individual name, but such conduct—nothing to the contrary appearing—is equivalent to a declaration by the agent that the money is received by him in his individual capacity, and for his individual use * * *.*"

In *Commercial Bank* v. *Jones*,[20] an agent, with the knowledge of the bank, deposited his principal's money in his own account. A portion of this money was subsequently applied upon an indebtedness from the agent to the bank, but a portion of it was applied to uses in which the bank was not interested. The court said:[21]

"It cannot be doubted that Dye [the agent] had authority to deposit this money in bank on account of the plaintiffs; if not conferred in express terms, at least impliedly from the nature of the transaction. It was intended by the plaintiffs that it should be so deposited. * * * *There can be no clearer proposition than that they had no right to pass the deposit to the private account of Dye.* Whenever they did so, they were guilty of a fraudulent conversion of the money of the plaintiffs; because they knew the money was not Dye's, but the plaintiffs', and that he had no authority or right to have it passed to his private account."

In *Duckett* v. *Mechanics Bank*,[22] a trustee deposited in his individual account a check drawn for deposit to his credit as trustee. The court held that the bank was liable because it had been instructed to place this check in a trust account. In the present instance, it might perhaps be said that in the case of all checks drawn to a trustee the bank impliedly is directed to credit the check to the trust account.

If it be regarded, thus, that checks drawn to a trustee are directed by implication to be deposited to a trust account, the case of *Ihl* v. *Bank of St. Joseph*[23] is also dangerous for the banks. Here the court held:

"If the plaintiff had directed the bank to credit the proceeds of the drafts to the account of A, and the bank had credited the

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[20] *Supra.*
[21] *Ibid.* 820.
[22] (1897) 86 Md. 400.
[23] (1887) 26 Mo. App. 129, 141.

proceeds of the drafts to the account of B, the bank would not have been thereby relieved of liability. The bank would have still owed to plaintiff the amount collected.

"The difference between the individual account of Frenger and the account of Frenger, as trustee, is quite as great as the difference between the account of A, and the account of B."

In the case, then, which we have supposed, of the banks and trust companies which sought advice of counsel during the year 1905 or before, the results were necessarily indefinite and unsatisfactory. The exact question was of novel impression in this State and the manner of the court's decision upon future cases could not well be prognosticated. It might have been said that the New York courts would probably follow the weight of authority as it existed outside of this State. Subsequent events, however, have proved the wisdom of such counsel as advised that the transaction was dangerous.

The first case which arose in this State was decided in December, 1906. In *Mills* v. *Nassau Bank*,[24] one Wallace, possessing a power of attorney from an executrix, indorsed a check drawn to her order as executrix and having then indorsed it with his own name, deposited it in his individual account with the defendant. The bank collected it and subsequently paid it out upon Wallace's individual checks. The Supreme Court in New York county refused to regard the defendant as liable, holding analogous the cash transaction which we, at the outset, have considered. Blanchard, *J.*, said:

"The power of attorney was sufficient to authorize any debtor of the estate to pay over to Wallace the amount of his debt in cash in satisfaction of his debt. Similarly, it authorized Wallace, if he so desired, to employ the usual agency of the bank to collect the claim, and thereafter to receive the cash from the bank. It cannot be contended that anything different has been done in the present case, where the bank, instead of physically delivering the cash to Wallace, has credited him with the amount upon its books. So long as the bank delivers to Wallace the cash or holds itself ready to deliver the cash upon order at any time, without asserting any set-off against the indebtedness by reason of extraneous transactions, it has performed its duty. The application which Wallace made of the funds thus placed to his credit can no more be the responsibility of the bank than can the disposition of the cash which Wallace might have received in case he had exercised his legal right under the power of attorney and received the proceeds of the check in money."

[24] (N. Y. 1906) 52 Misc. 243.

No appeal was taken from this decision, so that it was not until some time afterwards that the higher courts received the opportunity to express their views. When they did, however, the divergence of opinion which resulted among the various judges, to whom the question was presented, is remarkably interesting.

In May, 1909, the New York Special Term rendered a decision overruling the defendant's demurrer to the complaint in an action brought by the *Havana Central Railroad Company* v. *Knickerbocker Trust Company.* The facts alleged in the complaint were as follows: One Van Voorhis, the treasurer of the plaintiff corporation, drew certain checks to his order signed in the name of the Havana Central Railroad Company by himself as treasurer. These checks were drawn upon the deposit account of the plaintiff corporation with the Central Trust Company. Van Voorhis then indorsed the checks and deposited them in his individual account with the defendant Trust Company. The defendant, thereafter, presented them to the Central Trust Company; and having received the proceeds, credited them to the individual account of Van Voorhis. By him they were subsequently misappropriated.

Upon appeal to the Appellate Division in the First Department,[25] it was decided by a vote of three justices to two that the complaint stated a cause of action, the ground of the decision being that the case was not different from the old *Gerard* case in which representative moneys were applied to individual uses. In effect the *Gerard* case was the basis of the prevailing opinion. On the other hand, two very able justices dissented upon the ground that the defendant Trust Company had no notice that Van Voorhis was paying his individual obligations with the moneys of his trust. Justice Scott could see no impropriety in the acceptance of the checks as a deposit "to the credit of the very person who was presumptively entitled to the custody of the fund." Nor in the paying out of the money upon individual checks, could he see any fault upon the part of the bank—believing that the result of the deposit of this money in the account of Van Voorhis, as an individual, was to render such individual account "in effect the account of Van Voorhis, as Treasurer."

In March, 1910, the case reached the Court of Appeals.[26] The interest which it, at that time, had aroused among banks and trust companies in general is shown by the fact that both the American

[25] (N. Y. 1909) 135 App. Div. 313.

[26] (1910) 198 N. Y. 422.

Bankers' Association and the New York State Bankers' Association applied to the Court of Appeals and received its permission to file briefs in support of the demurrer to the complaint. Their position was that to hold the defendant Trust Company liable under the circumstances would be to impose excessive hardships and burdens upon the banking world.

In spite of this general desire and effort to have the law settled upon the question which we now have under consideration, the Court of Appeals refused to settle it. By a unanimous decision it reversed the judgment of the Appellate Division—but upon the narrow ground that, *even if* the receipt of the check for credit to the individual account called for an inquiry on the part of the bank to which it was offered, the defendant Trust Company had fulfilled its duty in this regard by presenting the check to the Central Trust Company upon which it had been drawn. The court was of the opinion that the banking institution with which the account had been opened was the plaintiff's agent to satisfy presenting banks as to the validity of checks drawn upon the plaintiff's account. In such case the court held the defendant Trust Company was in the position of a "third person who has received it [the check] in good faith relying on the representation of the deposit bank that the check was all right and had subsequently parted with the money." It was not decided however, whether the bank which receives a representative check for deposit to an individual account is bound to make inquiry, for the necessity of such inquiry was assumed. Nor was it decided whether a liability would exist if the trustee should have a representative and an individual account in the same institution.[27]

The precise question under consideration, however, has at last come before the higher courts. In *Niagara Woolen Co.* v. *Pacific Bank*,[28] the Appellate Division for the First Department, in December, 1910, rendered its decision affirming the judgment of the court below in favor of the plaintiff. The Niagara Woolen Company had an account with the defendant. Philip Horowitz, who was president of the plaintiff corporation, opened an account in the same bank in the name of Philip Horowitz & Son—which

[27]The Havana Central Co. case, as decided by the Appellate Division, was followed in the First Department in Parks *v.* Knickerbocker Trust Co. (N. Y. 1910) 137 App. Div. 719, and in Lanning *v.* Trust Co. of America (N. Y. 1910) 137 App. Div. 722. Neither of these cases, however, is particularly important in the present connection.

[28](N. Y. 1910) 141 App. Div. 265.

was his firm name. In June, 1904, he began to deposit in this bank, to the credit of Philip Horowitz & Son, checks drawn to the order of the plaintiff, indorsed in blank in the name of the plaintiff by himself as president, and then indorsed with the firm name under which he did business. He continued to make such deposits until October, 1904, when the total of the plaintiff's checks thus deposited was eighty-nine. It subsequently proved that he had applied the proceeds of these checks to his own, or his firm's, purposes.

Divergence again took place between the justices of the Appellate Division. The majority of the court were again of the opinion that the case came within the principle of the decisions which impose a liability where representative moneys have been applied to individual obligations. As this decision is the latest expression of opinion in this State on the question, we may set it out somewhat in full:[29]

"I assume as the settled law of this State that if Horowitz had presented these checks to the defendant bank and asked the defendant to receive them as payment of an indebtedness existing in favor of the defendant against either Horowitz individually or the firm of Philip Horowitz & Son, of which he was a member, the defendant would have been put upon inquiry as to the right of Horowitz to use the money of the plaintiff to pay his individual indebtedness. (*Ward* v. *City Trust Co.*, 192 N. Y. 61; *Squire* v. *Ordemann*, 194 id. 394; *Havana Central R. R. Co.* v. *Knickerbocker Trust Co.*, 135 App. Div. 313, and cases there cited.) I also assume that the same rule would apply if Horowitz had presented these checks to the defendant and instructed it to collect them and pay a debt of Horowitz or his firm to a third party, the defendant thus having notice of the fact that Horowitz was using the plaintiff's checks to pay his individual indebtedness. As I understand the rule, *it is not based upon the fact that the bank received an advantage* by reason of this defalcation or breach of trust of Horowitz, *but solely upon the fact that the defendant was chargeable with notice that Horowitz was using the money intrusted to him as agent or trustee for a purpose not within the terms of his agency or trust, but for his own personal advantage.* This was not the case of one independent check, but a series of transactions extending over months, during which time there was a constant diversion of checks drawn to the order of the plaintiff deposited with the defendant, collected by it, and then applied by it to the individual account of Horowitz or his firm. By the act of Horowitz in depositing these checks, and of the defendant in accepting and collecting them, it became liable to Horowitz's firm,

[29] *Ibid.* 267.

and recognized its liability by paying out to the order of Horowitz's firm checks drawn on it by that firm. Was this notice to the bank that Horowitz was misapplying or using for his own purposes the checks drawn to the order of the plaintiff, and which upon their face appeared to be the plaintiff's property?

"* * * But applying the principle which the Court of Appeals has now definitely stated to be the law of this State, as illustrated in *Ward* v. *City Trust Co.* (*supra*), namely, that the question is merely one of notice to the bank, it seems to me that it can make no difference whether the bank knew that Horowitz was applying the proceeds of the checks belonging to plaintiff to his own debt to the bank or to satisfy his private obligations to others; that in either case, where inquiry would have at once disclosed the limitations of Horowitz's authority and that he was misappropriating the property of the plaintiff, *the bank cannot deliberately shut its eyes to facts which upon their face show a misapplication* and thus aid a defaulting officer or trustee in securing the proceeds of his defalcation."

Two of the justices (although not the same two as in the *Havana* case) again dissented from the majority upon the ground that, in the past, a liability has been imposed only where the bank, to which the diverted money was paid, "received it in payment of a debt, or in some way *reaped a benefit from the payment*"—thus becoming with notice an active participant in the diversion. Justice Scott expressed himself thus:[30]

"Where that fact has been absent, as for instance in a case like the present, where the bank was a mere conduit or collecting agency, asserting no title to or right to retain the money *for its own advantage,* a different rule has uniformly been adopted."

The *Niagara Woolen Company* case, then, is the present law of New York State. An appeal has been taken to the Court of Appeals from this judgment of the Appellate Division, but it will be some months before the much vexed question is finally decided. In the meantime we can but speculate as to what the outcome will be. In thus speculating we have what slight aid may be gathered by comparing the decision of the Court of Appeals in the *Havana Central Company* case with the prevailing and dissenting opinions in the *Niagara Woolen Company* case. In the latter case the prevailing opinion seems to have been based in part upon the theory that the Court of Appeals in the *Havana Central Company* case *"recognized* the duty to make inquiry and that a bank upon which the checks were drawn was the proper

[30] *Ibid.* 271.

person to inquire of, and its payment of the checks was an answer to that inquiry upon which the defendant could rely." As we regard it, however, the Court of Appeals did not *recognize* such duty, but merely *assumed* it, *arguendo,* for the language of that court was to the effect that *"if it be conceded* that the offer of such a check, for deposit to the individual account of an officer, calls for some inquiry * * * the Knickerbocker Trust Company in the present case did all that the law demands."

The prevailing opinion in the Appellate Division is based, also, upon the view that the liability of the bank does not depend upon the fact that *the bank received an advantage* from the transaction. We believe that this is the correct view, for the question involved is not the bank's *profit* but the bank's *notice* of misapplication. Of course, if the bank receives trust moneys in payment of a personal obligation, it knows of the misapplication. But it is not necessary that the bank receive such advantage, because there are many other instances in which, also, it would have notice of the misapplication.

The Court of Appeals, however, in the *Havana Central Company* case does make this comment:

"Here the checks were not designed to discharge any obligation *owing to the defendant.* The defendant merely collected the amounts thereof and placed the same to the credit of the payee."

While the language which we have just quoted did not properly form a part of the decision, it does indicate, nevertheless, that the court has given some consideration to the opinion which Justice Scott has expressed in dissenting from the majority of the Appellate Division in the *Havana Central Company* and the *Niagara Woolen Company* cases.

It is thus clear that the decision of the Court of Appeals cannot be foretold with any certainty. There seems, however, to be good ground for believing that it will reverse the judgment of the Appellate Division. To affirm it would be to impose upon the banks of this State a far more burdensome duty of care and inquiry than has ever been required of them before. The practical business difficulties of fulfilling such a duty would be great. If, however, the Court of Appeals should decide to reverse the two lower courts, it does not seem that it should do so on the ground stated by the dissenting opinion, in the *Niagara Woolen Company* case, which made the bank's profit the test of liability. The logical ground for reversal would seem to be that no notice

of an intent to misappropriate is to be gathered merely from the deposit of the moneys in an individual account, for in such a case it is not clear that there is to be *an application to personal uses.*

This view was, in part, the ground of Justice Scott's dissent in the *Havana Central Company* case (although he abandoned it in the *Niagara* case) and was supported to some extent by the language of the Court of Appeals in the same case:[31]

"The distinguishing feature between this case and the cases relied upon to support the judgment which has been rendered herein is that *in the cases cited the form of the transaction was notice to the party receiving the check or other instrument that it was sought to be used to pay an individual debt out of trust funds.*"

The Court of Appeals, therefore, may do one of several things:

First: It may affirm the judgment below and hold the bank to responsibility in *all* transactions where it accepts the trust check for credit to the personal account of the trustee.

Second: It may affirm the judgment below and hold the bank liable only where it has received for deposit in the individual account *a large number of checks,* as was the case in the *Niagara Woolen Company* decision.

Third: It may reverse the judgment below and hold that the bank is responsible only where it receives a personal advantage from the transaction.

Fourth: It may reverse the judgment below and hold that the bank is liable only where it has notice from a payment to itself *or otherwise* that there has been an *actual* application of the trust funds to purposes which are on their face, individual and personal.

The fourth course would seem to be the one which is most reasonable. There are many honest transactions in which trust checks are deposited in individual accounts and thence drawn to pay trust obligations. It is certain that many years would elapse before depositors would cease to make such deposits. In the meantime a continual duty of care and inquiry would be imposed upon the banks which are already burdened, particularly in New York City, with their full capacity of cares and responsibilities.

Nor in the case where the bank has no notice of an *actual* application to personal uses but only to a *possible* application, does it seem equitable to hold the bank to such a degree of responsi-

[31] *Supra,* 429.

bility. The trustees are chosen by persons who have, as a rule, unrestricted power of selection, and the bank, therefore, would ordinarily be justified in relying upon their fitness and honesty.

This reliance, however, should not be carried beyond its proper limits. Where there is an actual application to a debt which the trustee personally owes the bank, or to any other debt which is a personal obligation of the trustee, there is, *prima facie,* a misappropriation which the bank should not be allowed to disregard. The line of demarkation between an application to personal uses and a deposit in the individual account may seem to be rather vague; but there does seem to be a legitimate distinction between the two cases in that moneys of an individual account are not necessarily applied to personal debts, whereas in the case where the liability should exist there is no question that the use made of the check is personal.

There is another question which arises from the decision by the Court of Appeals in the *Havana Central Company* case. There the Central Trust Company in which the trust account was deposited was held to be the proper person from whom inquiry should be made by the Trust Company which received the check for deposit to the individual account. It would seem to follow that where the same bank has both the trust account and the individual account it, as the holder of the trust account, is the person to answer the inquiry of itself as the holder of the individual account. There is no adjudication, however, as to its liability where, as holder of a trust account it incorrectly approves of the deposit of trust checks to the individual account. In the *Havana Central Company* case the liability of the Central Trust Company was in no way decided nor even indicated. We do not believe, however, that a bank which holds both accounts can escape liability by the technicalities of any such dual personality, for if there is a fault in allowing trust moneys to be placed in personal accounts, the bank must be held responsible as holder of the trust account, if it is free from responsibility as holder of the personal account.

Prophesies, however, as to the future decision of the Court of Appeals are mere guess work. Until, then, our highest court shall either lay at rest or endow with life this spectre of the banking world, it must needs walk in its present form. In the meantime, however, the spectre has sufficient substance to cast upon the checks of a trust fund received for deposit to an indi-

vidual account, a shade closely resembling what the Court of Appeals, in the *Paviour* case, has called a "shadow." Whether this incipient shadow will disappear in the light of the decision which we await we cannot tell; but we do know that, until such time, it is of sufficient size and importance to require the banking community carefully to note its presence.

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